

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - EP/EO
Cincinnati, OH 45201

Date: AUG 29 2002



Employer Identification Number:

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Phone
FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(4) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

We advised you that you might, with some changes, qualify under section 501(c)(12) of the Code. You have determined that you do not wish to pursue exemption under that section because of the dissolution requirements.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

[REDACTED]

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Eric G. Lerner

Director, Exempt Organizations

Enclosures: 3

Enclosure 1

FACTS

You incorporated in [REDACTED] on [REDACTED] to: acquire and own by purchase, or gift or otherwise, or in any other manner lawfully acquire, manage and operate a community water supply system and lateral lines, manholes, pumping stations, and all other facilities and appurtenances necessary to maintain an adequate water supply for domestic consumption for the occupants of the property served by the association.

On [REDACTED] you purchased all of the water system know as the [REDACTED] [REDACTED] as referred to under State Health Department operating permit [REDACTED]

You are a membership organization. Membership in the organization is automatically acquired by purchase of a lot or tract of land connected to the water system within the area served by the corporation.

Your Bylaws sets forth the procedures established by your organization regarding your billing services:

Meters are read once a month, and bills are sent regularly for two-month period, sent out on or about the fifth of the month, with payment due by the 15th of the month in which sent.

There shall be a late fee due for any payment not received by the 20th of the month in which due, in the minimum amount of \$[REDACTED]. The Board may establish a higher fee.

If payment is not received within thirty days of its due date, then there shall be an additional \$[REDACTED] fee. All amounts due shall bear interest at the maximum rate allowed by law.

The Board may also have service terminated after sending a notice stating the time and date service will be disconnected, not less than thirty days after sending the notice.

The Board may, but shall not be required to, send a second notice.

In addition, each member by receiving water agrees that [REDACTED] has a right to place a lien on the owner's lot for unpaid fees, dues and assessments and that such lien shall be in accordance with the rules for [REDACTED] liens and foreclosed in the manner of [REDACTED] lines, or as mechanic's liens.

[REDACTED]
[REDACTED] shall provide all members and all new owners of lots with notice that nonpayment of [REDACTED] assessments may result in foreclosure of [REDACTED] lien and that the [REDACTED] protection under [REDACTED] shall not apply.

Your income is derived from monthly billing of the water system customers for basic minimum cubic feet of water consumed; then additional fees imposed for excess cubic feet of water consumption.

Page 3 of your 1024 application, question 8 states, "Current water system customers are free to drill private wells; value of current water systems stays with home connected and served." Your letter dated [REDACTED] states; "membership in the organization is available to any water user in the community served by our system who agrees to pay appropriate assessments. **Membership and assessments are obtained by the organization on a voluntary basis.**"

LAW

Section 501(c)(4) of the Code described that civic league or organizations not organized for profit that operated exclusively for the promotion of social welfare or local associations of employees, the membership of which is limited to the employees of the designated person or persons in a particular municipality and the net earnings of which are devoted exclusively to charitable educational or recreational purposes.

Section 1.501(c)(4)-1(a)(1) of the income tax regulations states this civic league or organization may be exempt a of:

- (i) it is not operated for-profit; and
- (ii) is operated exclusively for the promoting of social welfare.

Section 1.501(c)(4)-1(a)(2) of the regulations states in general that:

- (i) an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one, which is operated primarily for the purpose of bringing about civic betterment and social improvement.

Revenue Ruling 66-148, published in Cumulative Bulletin 1966-1, on page 143, held that a nonprofit organization formed for the purpose of establishing and maintaining a system for the storage and distribution of water in order to increase underground water levels in a community was exempt under section 501(c)(4) of the Internal Revenue Code.

[REDACTED]

The key element of that revenue ruling was: the increase in the level of the underground water table which resulted from the organization's activities benefited all residents of the community whose wells were supplied by the raised water table, regardless of whether they were members and regardless of whether they paid anything to the organization. Memberships and assessments are obtained by the organization on a voluntary basis.

In Lake Petersburg Association v Commissioner 33 T.C.M. 1974, 259, a nonprofit membership organization was created to construct a lake community in which it leased lots to members. The Court concluded that the organization was operated primarily for the benefit of its members rather than for the benefit of the entire community. The organization directly benefited only those people who were members. Exemption was denied.

CONCLUSION

You stated that you are similar to the revenue ruling cited above. You hold that membership and assessments are obtained by the organization on a voluntary basis. This statement is belied by the facts of your Bylaws. *Membership in the organization is automatically acquired by purchase of a lot or tract of land connected to the water system within the area served by [REDACTED]* Automatic membership is not considered voluntary.

[REDACTED] shall provide all members and all new owners of lots with notice that nonpayment of [REDACTED] assessments may result in foreclosure of the [REDACTED] lien and that the [REDACTED] protection under [REDACTED] shall not apply.

While you state, "current water system customers are free to drill private wells", membership in the water system is effective upon the purchase of the property. In addition, failure to pay the required fees could result in termination of the service. Thus, if one were unable to drill a private well, he/she would have no choice but to use your water services and be subject to the fees charged.

The rationale and key element of the cited revenue ruling is that all individuals of the community benefited from the activities of the organization regardless if they were members or if they were able to pay. In the case of your organization, membership is automatic and payment for services are required.

Based upon the cited precedence, we hold that your organization does not benefit the community as a whole but directly benefits those people who are members. Your excessive private benefit to members is not within the purview of 501(c)(4) of the Internal Revenue Code.